

## DEPARTMENT OF STATE REVENUE

02-20150673.LOF

**Letter of Findings Number: 02-20150673**  
**Corporate Income Tax**  
**For the Year Ending December 31, 2014**

**NOTICE:** IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

**HOLDING**

Real Estate Investment Trust ("REIT") provided sufficient documentation to show it was not a captive REIT and therefore, that penalty assessed was incorrect.

**ISSUE****I. Estimated Tax - Underpayment Penalty.**

**Authority:** IC § 6-3-1-3.5; IC § 6-3-1-34.5; IC § 6-8.1-5-1; IC § 6-3-4-4.1; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Indiana Dep't of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); I.R.C. § 856; I.R.C. § 857.

Taxpayer protests the assessment of the underpayment penalty.

**STATEMENT OF FACTS**

Taxpayer is a real estate investment trust ("REIT") operating in Indiana. Taxpayer filed a corporate income tax return with the Indiana Department of Revenue ("Department") for 2014. Taxpayer filed an amended Indiana return reporting its net income prior to payment of dividends and claimed a deduction for dividends paid by Taxpayer. However, the Department subsequently disallowed the deduction and treated that amount as an addback because the Department determined that Taxpayer was a captive REIT and assessed an underpayment penalty.

Upon further review, the Department adjusted line one of the IT-20 to be zero, which was Taxpayer's federal taxable income. However, the Department did not adjust the addback for dividends paid by a captive REIT. These adjustments resulted in an assessment for Taxpayer. Taxpayer's protest for the assessment was not timely and this decision will not overturn Taxpayer's untimeliness. Taxpayer protested the penalty, a hearing was held, and this Letter of Findings results.

**I. Estimated Tax - Underpayment Penalty.****DISCUSSION**

The Department would like to first address the procedural posture of this issue. The Department disagreed with Taxpayer's amended return and assessed Taxpayer for additional tax due. The assessment went to Taxpayer as a Demand Notice. No Proposed Assessment was sent to Taxpayer prior to the Demand Notice. The Department is notified that it did not follow the process described in [IC 6-8.1-5-1](#). After the Department amended Taxpayer's return, the Department should have issued a "proposed assessment" rather than a "demand notice" for the tax due difference. The "proposed assessment" allows Taxpayer to protest the assessment or pay it within 60 days of the assessment. IC § 6-8.1-5-1(d). By going straight to a "demand notice for payment," Taxpayer was not afforded the statutory right to protest.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012). Thus, the taxpayer is required to

provide documentation explaining and supporting its challenge that the Department's assessment is wrong. Also, when courts examine "a statute that an agency is 'charged with enforcing . . . [the courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" Indiana Dep't of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014) (internal citation omitted).

In order to address the estimated payment penalty issue, the underlying issue of whether Taxpayer is a captive REIT should be addressed. Taxpayer protests the imposition of corporate income tax. In particular, Taxpayer protests that it is not a captive REIT and thus should not be required to add back the dividends paid to its owners.

I.R.C. § 856 permits entities meeting certain ownership and operation tests to be classified as REITs for federal tax purposes.

(a) In general.--For purposes of this title, the term "real estate investment trust" means a corporation, trust, or association--

- (1) which is managed by one or more trustees or directors;
- (2) the beneficial ownership of which is evidenced by transferable shares, or by transferable certificates of beneficial interest;
- (3) which (but for the provisions of this part) would be taxable as a domestic corporation;
- (4) which is neither (A) a financial institution referred to in section 582(c)(2), nor (B) an insurance company to which subchapter L applies;
- (5) the beneficial ownership of which is held by 100 or more persons;
- (6) subject to the provisions of subsection (k), which is not closely held (as determined under subsection (h)); and
- (7) which meets the requirements of subsection (c).

(b) Determination of status.--The conditions described in paragraphs (1) to (4), inclusive, of subsection (a) must be met during the entire taxable year, and the condition described in paragraph (5) must exist during at least 335 days of a taxable year of 12 months, or during a proportionate part of a taxable year of less than 12 months.

(c) Limitations.--A corporation, trust, or association shall not be considered a real estate investment trust for any taxable year unless--

- (1) it files with its return for the taxable year an election to be a real estate investment trust or has made such election for a previous taxable year, and such election has not been terminated or revoked under subsection (g);
- (2) at least 95 percent (90 percent for taxable years beginning before January 1, 1980) of its gross income (excluding gross income from prohibited transactions) is derived from--
  - (A) dividends;
  - (B) interest;
  - (C) rents from real property;
  - (D) gain from the sale or other disposition of stock, securities, and real property (including interests in real property and interests in mortgages on real property) which is not property described in section 1221(a)(1);
  - (E) abatements and refunds of taxes on real property;
  - (F) income and gain derived from foreclosure property (as defined in subsection (e));
  - (G) amounts (other than amounts the determination of which depends in whole or in part on the income or profits of any person) received or accrued as consideration for entering into agreements (i) to make loans secured by mortgages on real property or on interests in real property or (ii) to purchase or lease real property (including interests in real property and interests in mortgages on real property);
  - (H) gain from the sale or other disposition of a real estate asset which is not a prohibited transaction solely by reason of section 857(b)(6);

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This Taxpayer has provided sufficient documentation to show that it meets these tests.

I.R.C. § 857(b)(1) imposes a tax on the "real estate investment trust taxable income" at the rates otherwise provided for C corporations. I.R.C. § 857(b)(2) provides that "real estate investment trust taxable income" is the taxable income of a REIT, with several modifications. One of the modifications under I.R.C. § 857(b)(2)(B) is a deduction for dividends paid.

Indiana law requires certain REITs to add back dividends paid; this provision is currently codified at IC § 6-3-1-3.5(b)(10). This provision requires a REIT to:

Add an amount equal to any deduction for dividends paid (as defined in Section 561 of the Internal Revenue Code) to shareholders of a captive real estate investment trust (as defined in section 34.5 of this chapter).

IC § 6-3-1-34.5 provides that:

- (a) Except as provided in subsection (b), "captive real estate investment trust" means a corporation, a trust, or an association:
- (1) that is considered a real estate investment trust for the taxable year under Section 856 of the Internal Revenue Code;
  - (2) that is not regularly traded on an established securities market; and
  - (3) in which more than fifty percent (50 [percent]) of the:
    - (A) voting power;
    - (B) beneficial interests; or
    - (C) shares;are owned or controlled, directly or constructively, by a single entity that is subject to Subchapter C of Chapter 1 of the Internal Revenue Code.
- (b) The term does not include a corporation, a trust, or an association in which more than fifty percent (50 [percent]) of the entity's voting power, beneficial interests, or shares are owned by a single entity described in subsection (a)(3) that is owned or controlled, directly or constructively, by:
- (1) a corporation, a trust, or an association that is considered a real estate investment trust under Section 856 of the Internal Revenue Code;
  - (2) a person exempt from taxation under Section 501 of the Internal Revenue Code;
  - (3) a listed property trust or other foreign real estate investment trust that is organized in a country that has a tax treaty with the United States Treasury Department governing the tax treatment of these trusts; or
  - (4) a real estate investment trust that:
    - (A) is intended to become regularly traded on an established securities market; and
    - (B) satisfies the requirements of Section 856(a)(5) and Section 856(a)(6) of the Internal Revenue Code under Section 856(h) of the Internal Revenue Code.
- (c) For purposes of this section, the constructive ownership rules of Section 318 of the Internal Revenue Code, as modified by Section 856(d)(5) of the Internal Revenue Code, apply to the determination of the ownership of stock, assets, or net profits of any person.

IC § 6-3-4-4.1 provides that:

- (c) Every corporation subject to the adjusted gross income tax liability imposed by this article shall be required to report and pay an estimated tax equal to the lesser of:
- (1) twenty-five percent (25[percent]) of such corporation's estimated adjusted gross income tax liability for the taxable year; or
  - (2) the annualized income installment calculated in the manner provided by Section 6655(e) of the Internal Revenue Code as applied to the corporation's liability for adjusted gross income tax.

A taxpayer who uses a taxable year that ends on December 31 shall file the taxpayer's estimated adjusted gross income tax returns and pay the tax to the department on or before April 20, June 20, September 20, and December 20 of the taxable year. If a taxpayer uses a taxable year that does not end on December 31, the due dates for filing estimated adjusted gross income tax returns and paying the tax are on or before the twentieth day of the fourth, sixth, ninth, and twelfth months of the taxpayer's taxable year. The department shall prescribe the manner and forms for such reporting and payment.

(d) The penalty prescribed by [IC 6-8.1-10-2.1](#)(b) shall be assessed by the department on corporations failing to make payments as required in subsection (c) or (f). However, no penalty shall be assessed as to any estimated payments of adjusted gross income tax which equal or exceed:

- (1) the annualized income installment calculated under subsection (c); or
- (2) twenty-five percent (25[percent]) of the final tax liability for the taxpayer's previous taxable year.

In addition, the penalty as to any underpayment of tax on an estimated return shall only be assessed on the difference between the actual amount paid by the corporation on such estimated return and twenty-five percent (25[percent]) of the corporation's final adjusted gross income tax liability for such taxable year.

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In this case, Taxpayer has provided sufficient documentation to show it is not a captive REIT. To be considered a captive REIT, a REIT must meet the tests set forth under IC § 6-3-1-34.5(a)(1), (a)(2), and any one of the criteria

set forth under (a)(3). Taxpayer does not meet the criteria for (a)(2) and (a)(3) and therefore does not meet the definition of a captive REIT under IC § 6-3-1-34.5. Taxpayer has met its burden as described under IC § 6-8.1-5-1(c). Thus, since the assessment would have been incorrect the underpayment penalty assessed is incorrect.

### **FINDING**

Taxpayer's protest is sustained.

*Posted: 04/27/2016 by Legislative Services Agency*  
An [html](#) version of this document.